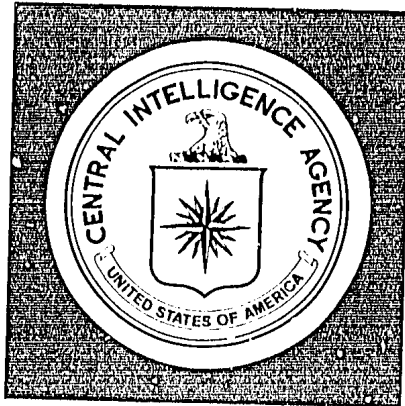


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Intelligence Report

The Economic Situation in South Vietnam, February 1975

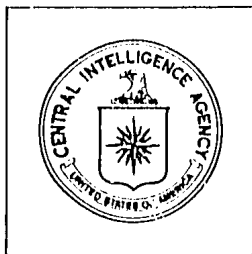
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The Economic Situation
in South Vietnam,
February 1975

SUMMARY

While South Vietnam's aid needs dominated discussions here and abroad, its economy passed through a rather subdued Tet buying season. As in the past, there was a temporary surge in the cost of living, but by the end of February most of this increase had been reversed. Saigon prices are up about 3%-4% from the start of the year, and there are no signs of anything approaching last year's first-quarter price increases of 20%.

There were mixed signals on the key issue of foreign earning capacity, as exports fell sharply and another oil discovery was announced. January export receipts were down to less than US \$4 million, continuing a trend that has been under way since mid-1974. The oil discovery, a Mobil strike in early February, reinforced the Pecten Vietnam conclusion in October 1974 on significant hydrocarbon presence but went no further in establishing whether the amounts and costs justified early exploitation.

Other topics discussed this month include:

- The 1974-75 "rice war" in the Mekong Delta; and
- a bright spot for exports in the development of the Saigon Export Processing Zone.

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Note: Comments and queries regarding this report are welcomed. They may be directed to [redacted] of the Office of Economic Research, [redacted]
[redacted]

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DISCUSSION

Market Conditions¹

1. The Saigon consumer price index surged upward 10% during the first two weeks of February, mostly as a result of last-minute buying for the Tet holidays and another lesser religious observance, and then receded 8% during the remainder of the month as the festivities came to an end. This seasonal spurt broke the relative price stability that had prevailed in the capital since late last summer. At the end of February, the price index was up 3.5% for the year. This was a considerable difference from early last year when by mid-February there had already been a 17% boost in prices.

2. Currency markets were essentially steady over the period, although there is still a speculative premium of 10%-15% on the dollar. From mid-December to mid-February, the black market exchange rate for US \$10 bills moved within the narrow range of 782-795 piasters to the dollar (compared with the official exchange rate of 700 piasters to the dollar). The price of gold has also been stable. After receding from the peak level of \$219 a troy ounce at the end of December, the price settled at about \$200 an ounce through mid-February.

Export Earnings Continue Decline

3. January export earnings of only \$3.7 million were the lowest in two years. This disappointing performance continues a trend that began in mid-1974 and led to a decline in average monthly export receipts from \$7 million in the first half of the year to only \$5 million in the second half.

4. A sharp fall in timber shipments, driven by both production and market problems, accounted for much of the January decline. Shortages arose as loggers suffered heightened Viet Cong harassment in recent months. Meanwhile, foreign construction industries -- Japan's, especially -- have continued to buy less wood over the past year as consumer demand has shrunk, building costs have soared, and credit markets have held fairly tight.

5. Vietnam's exports have also been hurt by inadequate financial incentives and credit availability. Several recent studies -- both official and private -- conclude that the effective export exchange rate² is not high enough now to encourage

1. Charts showing selected economic indicators follow the text.

2. Defined as the official exchange rate plus export subsidies of 7%-13%.

either greater promotion of traditional exports or expansion into new export lines. Moreover, exporters suffer from the financial effects of operating in a depressed home and world market in which domestic prices have increased more than 30% in the last year while the money supply was growing only about 20%.

6. Serious complaints raised in the studies about institutional obstacles include:

- lack of coordination between government agencies responsible for production and marketing of export products;
- communications gaps that prevent exporters from adequately learning about both domestic supply sources and international sales markets;
- inefficient export promotion that limits buyers' familiarity with Vietnamese goods and that fails to concentrate on the most lucrative markets;
- poor quality standards;
- complicated and expensive export procedures required by the government; and
- hidden tax and transport costs that reduce profit margins unpredictably.

Although some of these criticisms apply to most less developed countries, they also reflect recognition that the initial stimulus to export earnings during 1971 through early 1974 from more realistic exchange rates must be supported by vigorous efforts to re-educate businessmen and bureaucrats who were out of the world market for most of the 1960s.

Another Well Shows Oil

7. On 12 February, Saigon announced the second promising discovery of oil in coastal waters within the past four months. The recent testing of Mobil Oil Company's first exploratory well showed a total daily flow of about 3,000 barrels of oil and 200,000 cubic feet of gas. Mobil is carrying out further tests to determine if the well is commercially exploitable.

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8. There is no longer any question of the widespread occurrence of oil off South Vietnam. What is unknown is whether there is enough to merit exploitation, given the high costs of offshore extraction and security considerations. The Mobil discovery is similar in size to a Pecten Vietnam find last October, the commercial feasibility of which also is uncertain.

The 1974-75 "Rice War"

9. The upsurge of fighting in the Delta coincident with the main 1974-75 harvest season has had only limited impact on farming. Although the press has called the increase in military activity a "rice war," it appears to be no more than a continuation of the relatively ineffective Communist effort to undermine the Thieu government in the Delta and to enlarge Communist control over land and population there. In fact, there are no signs that the Communists are specifically intent on capturing or disrupting large parts of the rice harvest. There has been almost no destruction of crops either in the field or in storage, relatively little interdiction of major transport routes, and little disincentive for farmers to get on with the harvest and plant a second crop. Some farmers have been forced to flee temporarily because of localized fighting, but only rarely have fields been abandoned.

10. The Communists in the Delta have been able to meet their own relatively small food needs.³ This has been accomplished primarily through the taxation of local farmers. Tax collections, in both rice and money – depending on local needs, storage facilities, and manpower – have reportedly risen this harvest season. The scale of the collections, however, is still small enough that Delta surpluses are adequate to fill the needs of Saigon consumers and those in deficit provinces.

11. The government is in a strong position to counter any potential "rice war." Rice stocks in Saigon are substantial – more than 200,000 metric tons – and progress continues in efforts to improve the effectiveness of government procurement policies. For the first time, rice purchases by the National Food Agency are being made locally in the Delta, rather than in Saigon. This should increase deliveries out of the Delta by making it easier for merchants without their own means of transportation to sell their rice. The government is also making increased credit available to the rice merchants, which – although interest rates are not as favorable as they were a year ago – will provide a further stimulus to rice trade.

3. All the Communist forces in the Delta could be fed for a year on less than one-half of one percent of the Delta's 4.4 million tons paddy harvest.

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Progress on the Export Processing Zone

12. An important step in streamlining official processing of exports and in reducing exporters' costs is the building of an export processing zone (EPZ) near Saigon. The EPZ, which should become a major source of export revenues when it becomes fully operational in a year or so, is being developed with US and Taiwanese help. A US consulting firm did most of the engineering for the conversion from military to industrial use of 12 hectares of the former US-built Camp Davies. Taiwan has provided technical assistance in setting up the export-incentive regulations under which tenants of the zone operate. These include:

- a five-year holiday from corporate taxes;
- exemption from most registration, license, and export taxes;
- duty-free import of machinery, raw materials, and semifinished goods;
- accelerated depreciation;
- freedom from nationalization and government competition in similar product lines; and
- foreign currency privileges.

13. Expansion of the EPZ takes on added importance as the decreasing profitability of some of its primary exports compels the government to place greater emphasis on manufactures. Since development of the EPZ began in mid-1974, seven companies have already begun to set up operations or will do so shortly. The government expects some 25 firms to be in operation on the original EPZ site within a year and is considering further expansion onto another 105 hectares sometime in the future.

14. The present seven firms – with US, Hong Kong, Taiwanese, Japanese, and French as well as Vietnamese participation – will employ some 3,500 workers manufacturing garments, knitwear, gloves, and wood products with net exports of some \$6 million the first year. One garment maker should produce the zone's first exports within the next few months. With a relatively small total investment of \$3 million, the seven firms will be able to take advantage of Vietnam's highly skilled, easily trained, and relatively low-cost labor supply at a time when labor costs in Hong Kong, Taiwan, Singapore, and other competitors are rising sharply.

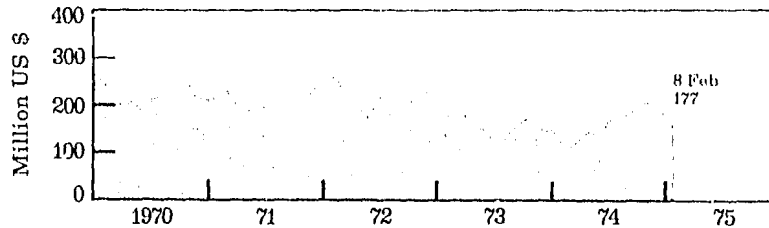
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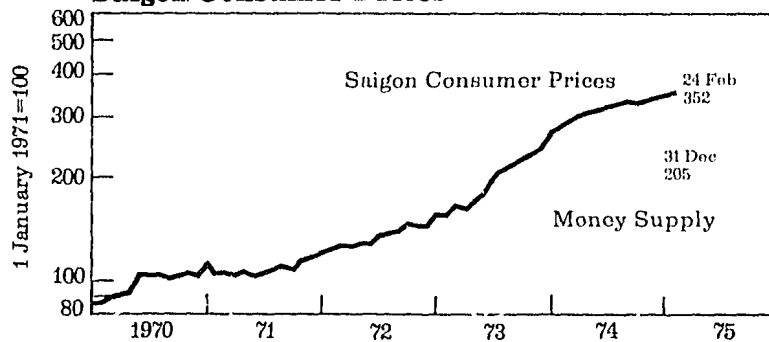
South Vietnam: Economic Indicators

Unless otherwise indicated, data are as of the end of the month.

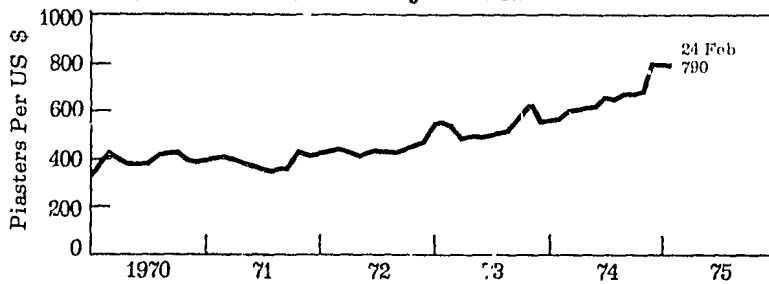
Foreign Exchange Reserves



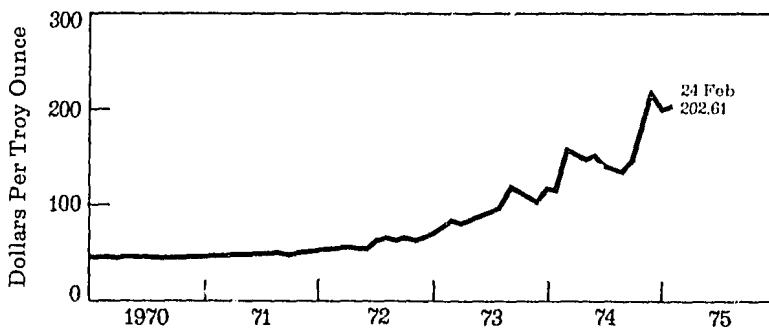
Indexes of Money Supply and Saigon Consumer Prices



Free Market Currency Prices



Free Market Gold Prices

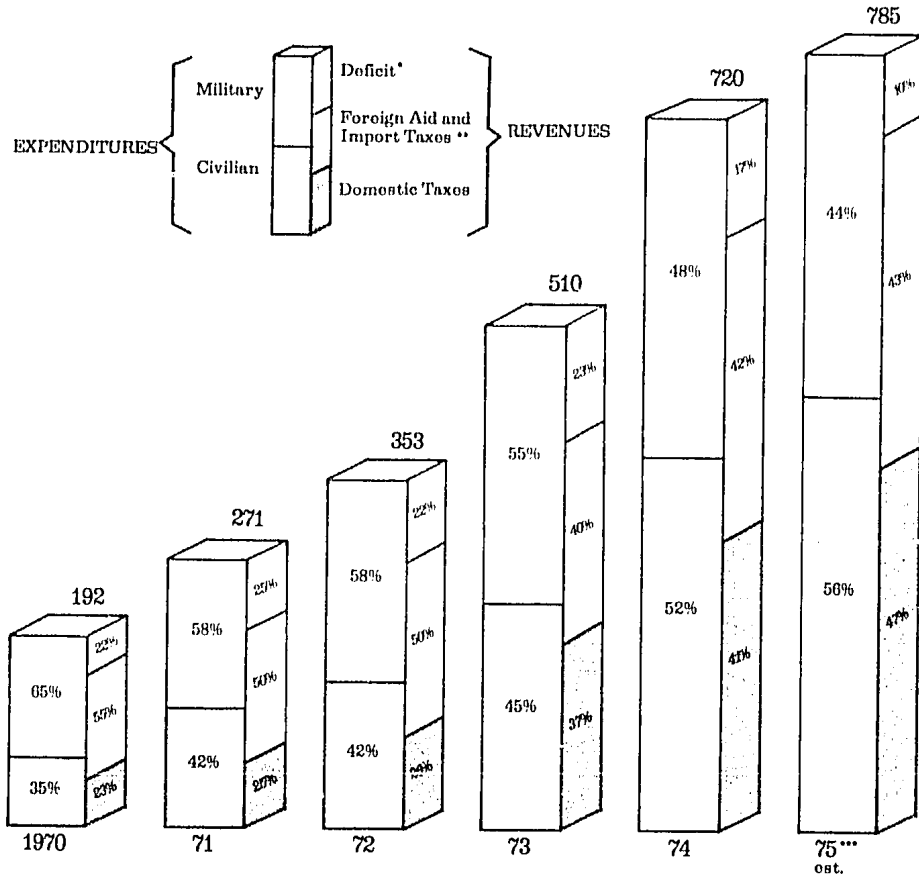


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South Vietnam: Government Budget

Billion Piasters



* Residual. Financed primarily by borrowing from the National Bank.

** Includes customs duties and other import taxes, counterpart funds generated by US and other countries' import programs, and profits from foreign exchange transactions.

*** Does not include rice, fertilizer, and export subsidies, which may add as much as 100 billion piasters to 1975 expenditures.

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